UPWARD MOOD IN 4TH QTR. MARKET INTEREST RATES

Both short-term and long-term interest rates declined in the first half of this year, but they began to rise during the mid-2nd quarter and continued through the end of November. The yield on 3-year corporate bonds declined to 10.43 percent at the end of April, its lowest level in several years, but since then it has risen. The yields on monetary stabilization bonds, bank debentures (KDB Bond + KLTCB Bond), and national housing bonds have also shown upward trends since the second half.

One interesting phenomenon is that although the government tried to lower the reserve ratio and/or rediscount rate to help firms reduce their financial costs, interest rates have not decreased. There are several reasons which came into play. The bearish stock market during the second half of the year made it difficult for many firms suffering from sluggish exports to maintain sufficient working capital, which forced them to increase the issuance volume of corporate bonds. Secondly, though the government continued to insist on pursuing lower interest rates, most market participants were skeptical of the downward trend in interest rates due to the inflation rate. Because of the rising current account deficit and devaluation of Korean won, many are worrying about prices. The financial institutions' lack of purchasing power to buy bonds and their reluctance to purchase bonds have further raised interest rates.

The yields on several bonds during November marked patterns similar to those of the third quarter. The numerous campaigns by financial institutions for tax-free household long-term savings accounts since this month may also raise interest rates on deposits. Higher demand for money due to payments of income tax and corporate tax further raised interest rates.

The increases in the demand for working capital and seasonal factors including demand for funds for the Christmas and New Year's Day holidays will cause an upward trend in movement in December. In addition, the higher level of M2 growth may work as a negative factor to bond buyers. Because of the recent upward mood of interest rates, institutional investors who are eager to sell their holdings are not likely to participate in the bond market actively so the supply/demand situation for bonds may worsen in December. However, the low demand for money from firms due to decreasing facility investment can help stabilize the money market. Overall, the money market and trends of interest rates are likely to stay similar to November's unless the government changes its monetary policy dramatically. VIP

(Chan-jin Kim)

"Interest rates are likely to rise steadily in December as November's pattern."

<Table 1> Average Yields On Major Bonds

	1995				1996			
	1st	2nd	3rd	4th	1st	2nd	3rd	Oct.~11.23
Monetary Stabilization[1]	14.08	14.20	13.45	12.14	11.84	11.23	12.55	12.80
Corporate[2]	15.06	14.75	13.44	12.30	11.88	11.18	12.14	12.10
Bank Debenture[1]	15.40	14.91	13.52	11.98	11.96	11.26	12.82	12.89
National Housing[3]	14.01	13.38	12.06	10.14	10.40	10.42	11.31	11.29

Notes: 1) 1 year maturity, 2) 3 year maturity, 3) 5 year maturity
Source: Bank of Korea